

Relationship between savings and inflation



Savings help cushion the business cycle as the economy faces hard economic situations (Syden, 2014). To have a sustainable economic growth, there is a need for sustainable resources to support it. That is why savings are needed to finance capital spending. These high savings rate levels have allowed the economy to gain high levels of investment (Horioka & Terada-Hagiwara, 2011). China's domestic savings rate is one of the highest in the world (Loayza, Schmidt-Hebbel, & Serven, 2000). Inadequate savings would leave the economy vulnerable to shocks in income uncertainty and unexpected rise in prices.

At 52% of the national GDP, China's domestic savings rate is among the highest in emerging markets inadequate savings leave households vulnerable to shocks in income and rising prices, add burden to government in providing retirement assistance, constrain individuals in accumulating wealth inadequate savings leave households vulnerable to shocks in income and rising prices, add burden to government in providing retirement assistance, constrain individuals in accumulating wealth.

Many factors come into play with regard to how much to spend and how much to 'keep' for future spending.

REVIEW LITERATURE

There have been a lot of theoretical and empirical research studies about the relationship of savings on different factors like inflation rate, unemployment rate, and interest rate.

It has been argued that savings are important, and when the economy is hit hard, having money in the bank can ease the problem (Elmerraji, 2010).

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Saving rates around the world differs widely. (Loayza, Schmidt-Hebbel, & Serven, 2000) stated that China, world's fastest growing economy, had one of the largest national saving rates in the world. Those at Sub-Saharan Africa save less than 15% of their gross national disposable income while East Asia saves more than 30%. In recent years, saving rates have doubled in East Asia while those in Latin America were stagnated.

What people do not spend after consuming part of their income is called personal savings. People tend to put their savings on bank accounts or partly invested (Piana, 2003). Given a certain income, the decision of consuming a good negatively affects savings. Postponing such consumption would increase savings and in contrast, savings can rise due to negative expectations for future income.

As economic shocks occur on business cycles, households experience hard time in unexpected reduction in income. According to the Life-cycle hypothesis by Milton Freidman, people would eventually save more and minimize consumption to avoid future uncertainty.

(Zaman, Carannate, & Ferra, 2013) In times of economic crisis like the recent financial crisis on 2008, policy measures and uncertainty affects household consumption and saving decisions. In the Spanish economy, after the great recession, there has been an evolution of saving rates (Bande & Riveiro, 2012). The behavior of households has changed after the great recession, through increasing saving rates. Large increase in savings rates is connected to the increased uncertainty in the future (Bande & Riveiro, 2012).

EMPLOYMENT

Macroeconomic instability which is measured by inflation, causes an upward trend in saving. The season of high inflation and high unemployment, as well as cutting public benefits have raised income uncertainty and changed the expected future income of the economy (Chowdhury, 2014).

When an economy has a crisis, it leads to unemployment, and the risk of future uncertainty in income makes households save more (Zaman, Carannate, & Ferra, 2013). When part of the households are affected with future uncertainty of income, it stimulates to low demand and consumption which would worsen the economic situation of the country. Financial crisis happens when labor market is distorted with high unemployment, changing households' structure of saving portfolio. Any sort of financial crisis leading to a recession would have a significant effect on household savings.

ECONOMIC GROWTH

Growth models includes Harrod (1939), Domar (1946) states that economic growth is highly dependent on level of savings and output ration. These models indicate that increase in saving means high investment which stimulates economic growth. The availability of funds for investment increases as effect of having higher savings (Sothan, 2014). The higher the level of saving rate leads to increased capital stock that in progress leads to a high level of output.

Business Cycle

Different economies go through different patterns of ups and downs in the value of its Gross Domestic Product (Riley, 2012). This business cycle has

four phases namely boom, recession, depression, and recovery. Economic boom has high consumer spending, profits, and investment. Unemployment tends to be low in this economic situation. Economic Recession has low level of consumer spending, income, and investment, and has a rising unemployment as businesses cut costs. Economic depression is when there is a declining GDP, showing weak level of consumer spending and investment, rapid rise of unemployment and prices starting to fall. Economic recovery is when economic situation starts to get better and consumers begin to increase spending and investment.

Every country's goal is for an economy to achieve a sustainable level of growth (Riley, 2012). Trend growth rate is what helps assess and compare the growth of the different economies.

(Lequiller & Blades, 2007)

REVIEW OF RELATED LITERATURE

EFFECT OF INFLATION ON SAVINGS RATE

Almost all the past literatures that were found concerning the relationship of the variables inflation rate and savings rate concluded that the relationship between the two are positive and significant. In a cross-sectional data on inflation rates and savings rates of various countries in the world, both developed and developing, the results obtained in the recent study showed that inflation rates of all the countries positively impacts each of the countries' savings rate (Cheng & Li, 2014). El-Seoud (2014) conducted a study on the effect of Gross Domestic Product, interest rate, and inflation rate on the national saving rate in the kingdom of Bahrain over the past 20

years. The researcher found that inflation rate has a positive relationship and significant impact on Bahrain's saving rate in both the long run and short run. Similarly, Syden (2014) also found that in their study of South Africa's 48 years of household savings data, inflation significantly creates a positive impact on the continent's saving rate. As for the case of Turkey, Er, Tugcu, & Coban (2014) used the Autoregressive Distributed Lag approach and the study's results indicated that there that inflation positively affects inflation rate and savings but there was no relationship of significance between inflation and savings in the short run. Using two stage least squares model, the study of Chaturvedi, Kumar & Dholakia (2009) on the relationship between economic growth, inflation, and saving rate in Asia revealed that inflation rate has a positive effect on the interest rates of the Asian countries as well. On the other hand, Heer & Suessmuth (2006) utilized data of the inflation and saving rates from United States postwar period in order to analyze the monetary policy regimes of the three eras, namely the Pre-Volcker Era ('65-'78), Volcker Era ('79-'87), and the Greenspan Era ('88-'98). There appeared to be ambiguous results on the effect of inflation on the saving rates. In the Pre-Volcker Era and Greenspan Era, inflation negatively affected the saving rates. In the Volcker Era, on the other hand, inflation is positively associated with saving rates (Heer & Suessmuth, 2006).

EFFECT OF INTEREST RATE ON SAVINGS RATE

El-Seoud (2014) concluded from his previously mentioned study that the interest rate in Bahrain, just like inflation, has a positive and significant effect on the national saving rate in the short run. However, in the long run, El-Seoud (2014) saw that while the interest rate still has a positive relationship

on Bahrain's saving rate, this effect is now insignificant. On the other hand, in the results acquired from the study of Syden (2014) on South Africa, it showed that interest rate has a negative relationship and significantly impacts the saving behavior of South Africa. In a study on the Turkish economy, the researchers found that there was no significant relationship between interest rates and saving rate found in the long run (Er, Tugcu & Coban, 2014).

(Challe & Ragot)

(Romer)

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